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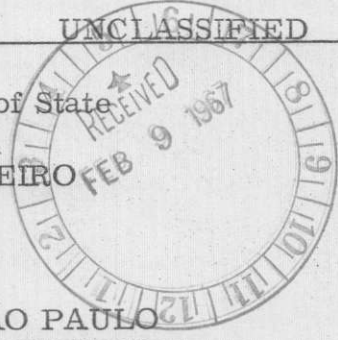
TO : Department of State

INFO : RIO DE JANEIRO

FROM : Amconsul SAO PAULO

SUBJECT : Current Economic Situation in São Paulo

REF : CERP D



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ANALYSIS BRANCH
DATE: January 30, 1967

1. Summary of General Economic Conditions

There has been no apparent improvement in the general trend of the São Paulo economy - in fact the pace of price increases is reported to have considerably accelerated during January. Previous chronic problems are still very much in evidence, e. g., tight bank credit, declining real purchasing power of the mass of the public, inflation, a high rate of bankruptcies, creditors' agreement, protested notes, and stagnating sales and output in various key industries. In spite of these problems, however, there appears to be continued general confidence in and support for the general direction of the government's economic policies, reinforced by the belief that business will pick up after March 15 when Costa e Silva is inaugurated. Paradoxically, some major industries increased their prices substantially in January in spite of slack sales of their products during the past several months.

The majority of businessmen agree that one of the present key economic policies of the government should be relaxed - namely, bank credit. At the same time, labor and the middle class feel that they are bearing more than their share of the burden of the stabilization program and believe consequently that the government's restraint on wage increases should be eased. These groups point to the present business downturn as evidence that these restraints should be relaxed as being the prime factors causing the present mild recession. Most hopefully believe that Costa e Silva will take a softer line in seeking price stability and few appear to perceive any basic conflict or inconsistency in easing up on

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restrictive wage and credit policies, while at the same time trying to conquer inflation, a battle which all agree is far from won.

Bank credit, for example, a favorite target of chronic dissatisfaction in the business community is still reported to be tight. Data published by the Roberto Vidigal Institute for November 1966 for commercial bank loans in São Paulo show their level in November 1966 at Cr\$2.918 billion compared to Cr\$2.391 billion in November 1965 (during which period the São Paulo cost of living increased by 47.4 percent).

The U. S. Chamber of Commerce for São Paulo stated in its annual report on the Chamber's activities during 1966, presented at its 48th annual general meeting here on January 26, 1967, that "...the purchasing power of the middle class has been seriously curtailed," at the same time reporting that Christmas 1966 sales had been the worst in many years and that year-end inventories of household goods and domestic appliances were high. City of São Paulo data for 1966 reflected a 46.3 percent increase in the cost of living compared to 40.1 percent in 1965. Food costs in 1966 rose by 50 percent over 1965, housing by 46 percent, clothing by 41 percent, light and heat by 53 percent and transport by 53 percent. By comparison, however, with 1963 and 1964, when São Paulo cost of living indexes rose by 80.5 and 85.6 percent respectively, 1965 and 1966 performance was very encouraging. However, present forecasts of the probable cost of living increase during 1967 have recently become more pessimistic, especially since the consensus reports a substantial rise in prices during January. These observers believe that if the average rise is five percent or higher during January, the chances for the government to achieve price stability (i. e., an increase of 10 to 20 percent) this year are dim indeed.

Motor vehicle sales prices have been increased in January by between 8 and 19 percent in spite of poor sales during the past several months and declining output, which has been down each month since September by over 20 percent compared to the monthly level during the first three quarters of 1966.

Retail sales here, including electric appliances, continued to be slack, although appliance prices were increased in January by 7 percent.

Textiles are still in the doldrums, although civil construction activities in São Paulo have improved as a result of increased City of São Paulo public works spending.

Some factors providing the push behind the recent surge in the rate of price increases, aside from an apparent growth in inflationary expectations of the

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business community, were the 8 percent deposit which all firms must make to the new labor Guarantee Fund for Length of Service (although the net increase was only 2.8 percent), the January 1 circulation tax, rising food costs, and the anticipated increase by March of the minimum wage. Other woes of the business community included the "inflation" of legislation, a name recently coined here to describe the large number of recent federal decrees and laws.

With respect to the inauguration of President-elect Costa e Silva on March 15, São Paulo business leaders hope for a key post or two in the federal cabinet, particularly the posts of Finance and Economic Planning, with Secretary of State for Finance Delfim Netto being prominently mentioned for the latter, although he has just been named by the new Governor, Sodré, to remain in his Cabinet.

Meantime, the general level of employment appears to be holding up very well, considering the depressed state of business, apparently a situation considerably influenced by the feeling of the local business community that Costa e Silva's advent will spark a general business upturn through his easing of present restraints on bank credit and wage increases. Should this evaluation be in any manner seriously modified, the present mild business recession could well turn into a full-scale recession. (TDKingsley)

2. Finance

The São Paulo business community is considerably concerned by the Government decree authorizing the National Monetary Council to raise the limit of commercial bank's compulsory deposit with the Central Bank from 25 to 35 percent. Although the limit continues at 25 percent for the time being, local observers consider the decree to be a "sword of Damocles" dangling over banking establishments, to be used to brake inflationary credit and rising prices by drying up, if necessary, all but the most selective types of bank loans. The authorities advance the argument that the banks' liquid position will tend to rise soon when temporary deposits develop through implementation of the new workers' Guarantee Fund for Length of Service, under which firms must deposit monthly 8 percent of company payrolls. However, commercial banks will probably compete with each other to attract company deposits by offering incentives for special services (collections, payment of payrolls at tellers' windows, special loans to finance the extra cost of the new fund) and this type of service would entail an increase in the cost of bank operations which may well offset part of the advantage of receiving these temporary deposits from industry and trade.

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It is said that Central Bank resolution N° 46 does not clearly indicate whether Guarantee Fund deposits are subject to commercial banks' compulsory repassing to the Central Bank. Thus, the immediate result of the latest Government measure is that the major commercial banks in São Paulo are already moving to raise the level of their cash balances by reducing loan operations in order to cope with any sudden increase in the limit of the compulsory deposit. Bank loans in January 1967 among the five largest banks in São Paulo average 5 to 7 percent less than in November or December 1966.

Tight credit is raising the cost of money in São Paulo. Quasi "parallel market" operations in the past three weeks indicate that industrial firms are now paying over 4 percent monthly for non-bank short-term loans. To absorb this and other additional expenses (see item on prices), many firms are raising prices of their products. Previous ConGen reports pointed to the lack of liquid funds on the local financial market during 1966. This is reflected in figures now published by the São Paulo Stock Exchange indicating that trading in 1966 was nearly 5 percent less than in 1965 (Cr\$515 billion in 1966 as compared with Cr\$541 billion in 1965). The lion's share of the market went to letras de cambio of finance companies (76.7 percent), followed by readjustable obligations of the Federal Government (9.4 percent), corporate stock (7.8 percent), bank stock and debentures (3.8 percent), and miscellaneous paper (2.3 percent). In real terms (taking into account the rate of inflation in 1966) trading at the Stock Exchange in 1966 was about 35 percent less than in 1965.

A gradual deterioration of business conditions (presumably affecting more small and poorly organized firms than large corporations) was evidenced in 1966, according to comparative figures on São Paulo bankruptcies, petitions in creditors' agreements, and volume and value of notes protested, published by the Instituto Roberto Vidigal of the Commercial Association of São Paulo. Bankruptcies rose 53 percent (1965: 1686; 1966: 2585); petitions in creditors' agreement 60 percent (1965: 175; 1966: 379); number of notes protested 56 percent (1965: 89, 911; 1966: 140, 795); and value of notes protested a staggering 238 percent (1965: Cr\$20.1 billion; 1966: Cr\$68 billion). (ADventura)

3. Prices

The month of January heralded a wave of price increases in São Paulo which, by and large, have not been restrained to date despite mid-month stop-gap efforts of the Federal Government. Several negative factors are playing their role in this phenomenon, among them: wage increases, averaging 25-30 percent, awarded workers of the major labor unions; the switchover from the system of State sales and consignment tax to the new circulation tax

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which has encouraged temporary speculative activity, the effects of which may be long-lasting; implementation of the new federal tax on Industrialized Products (Imposto Sobre Produtos Industrializados) whose tax levels are, in many cases, higher than the levels of the old federal excise tax which it replaces; increased local taxes pushed through by the Mayor of São Paulo despite stiff opposition from both the business community and the Municipal Chamber; and -- last but not least -- the defiant attitude of numerous industrial firms which, claiming they operated in the red during the last quarter of 1966, now insist on raising prices to recoup their paper losses even at the cost of reduced production and sales.

A very disturbing element is the reappearance of the "inflationary mentality" after being partially dormant for over two years. The new minimum wage levels to be set in the period February-March and the devaluation of the cruzeiro (which some claim will take place before the new federal Administration takes office in March) will have a strong inflationary impact on the economy added to rising prices in January. Some businessmen are, therefore, raising prices now in order to "protect" themselves.

Figures published by São Paulo City Statistical Department indicate that cost-of-living for the lower income group rose 46.3 percent in 1966 compared with 41.2 percent in 1965. Officials of the Statistical Department state that a mid-January spot check reflects what may turn out to be a 3 percent increase for January 1966, although some private observers here have expressed the view that the cost of living in São Paulo will reach a record level. That the Federal Government is fully aware of this trend is evidenced by the decree law reducing by 50 percent the federal Tax on Industrialized Products for processed foodstuffs and authorizing State governments to reduce by the same proportion the new state circulation tax. According to São Paulo Secretary of Finance DELFIM Netto, the State of São Paulo will not reduce the tax. The circulation tax, which replaces the sales and consignment tax, represents over 96 percent of the São Paulo State revenue, and a tax reduction of 50 percent on processed foodstuffs might mean a drop in revenue of about 10 percent at a time when the State Government is unhappy at the low volume of total revenue from taxes. Some São Paulo businessmen argue that the Federal Government should have eliminated completely the Tax on Industrialized Products for processed foods, since its main revenue is provided from income tax and customs duties. (ADVentura/TDKingsley)

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4. Retail Trade

Reports from the major department stores in São Paulo indicate a sharp decline in sales in the first three weeks of January compared with the relatively listless sales movement for the corresponding period in December 1966 (see item 2, A-205 of January 3, 1967). Most department store officials are not surprised at the downturn which they had predicted as far back as October and November of last year. Inventories are high, collections poor, and efforts to induce increased consumer buying (through the usual clearance and seasonal sales) have been relatively unsuccessful. Stores are turning increasingly to the "young crowd" for sales of sporting goods, and attractive but expensive casual wear, which are readily accepted by the junior set.

Consumer durables are moving very slowly, despite long credit terms extended by the downtown stores. Strapped for cash, many stores have cut down their mark-ups to a minimum on refrigerators, washing machines, stoves and other electric household appliances, although factory list prices have increased an average 7 percent effective January 1, 1967.

The consensus is for a slight upturn in the sale of toiletries and clothing before Carnival, but most expect that there will be no substantial pick up in sales until April. (ADVENTURA)

5. Industry

January is generally a slow month. With few new orders on hand, most industrial sectors have shortened work weeks or gone out on collective holidays (some to stretch out to February), have rescheduled downward production programs for the first quarter of 1967, and are cutting down or stretching out orders for raw materials, parts and components from third party suppliers. These measures are being taken by industrial firms in order to try to emerge from an anticipated ^{slow} first quarter with lower inventories and sounder cash positions,

Although most consumer goods industries did poorly in the last quarter of 1966, and do not expect to chalk up substantial sales in the first few months of 1967, the general climate is one of sober reappraisal and an upturn after the March presidential inauguration rather than dejection and pessimism.

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Expectancy as to who will be appointed Planning and Finance Ministers in the Costa e Silva administration is leading prominent São Paulo businessmen to form into small pressure groups to try to ensure that men of their choice fill these important positions. State Finance Secretary Delfim NETTO is still being mentioned for the Planning Ministry.

Motor Vehicle production in January was slow. Auto plants have gone all out to sell off top-heavy finished inventories, but in the past two months, were reportedly very depressed. All São Paulo auto manufacturers raised prices in January by between 8 percent and 19 percent. New models and face lifts were introduced by Willys, Vemag, Volkswagen, Simca, Ford, and GM. In recent weeks, two manufacturers went out on collective holidays, while three more reduced work-weeks to four days. Supplies from auto parts manufacturers were cut an average 20 percent below October/November 1966 levels, and the consensus is that monthly motor vehicle output in the first quarter of 1967 will average not more than 15,000 to 17,000 units. Employment levels which had dropped in motor vehicles and textiles in December are expected to stabilize for the present. Since manufacturers believe that an upturn in business conditions will take place after March, they are reluctant to lay-off skilled and semi-skilled workers.

The auto parts industry is also experiencing a slump which is expected to last for at least another two months. While the larger firms remain fairly buoyant, some of the smaller part manufacturers are hurting badly; at least a dozen small firms petitioned in creditors' agreement in January. There are reports of mergers of several smaller companies with substantial fixed assets, but inadequate working capital.

Sales of agricultural tractors are down and are expected to continue slow until large-scale federal-backed financing is resumed, possibly sometime in March. (ADVentura/TDKingsley)

The electric household appliance industry is reducing output for the entire first quarter of 1967. Inventories at wholesale and retail levels are still high and few new orders have been placed with manufacturers. The industry is following the pattern of the auto industry by going out on collective holidays and shortened work weeks. Price increases averaging 10 percent were introduced in January, and have not resulted in increased sales. Slowest moving items remain refrigerators, washing machines, stoves and air conditioners. Radio sets and TV receivers are selling at a slow pace, while small appliances are still selling fairly well. (ADVentura)

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The number of petitions in creditors' agreement among textile manufacturers rose in January. As in previous months, these were mostly small or medium-sized firms with obsolete facilities. In January, some large textile companies reported good sales of fine cotton stamped goods. Dacron-based and other light weight fabrics are also selling fairly well. By and large, however, the industry is suffering from an extended downturn which may last until the beginning of the winter season.

The public works sector of the civil construction industry reports a substantial business pick-up as the city government expands construction of viaducts, roads, and the paving of streets. The State and Federal Governments, after protracting in November and December payment for work already done, are now paying off debts and pushing through new programs, a large proportion of which has been awarded to São Paulo construction firms. Few apartment buildings are being launched in São Paulo at this time because of the holidays. Instead, realtors are concentrating on the summer resorts for sales of co-op apartments and houses. (ADVentura)

The shoe industry is currently going through a period of near recession. Major manufacturers, however, are implementing expansion programs entailing the installation of modern machinery with a view to cutting costs through higher productivity. (ADVentura)

6. Labor

The new annual wage readjustments which occurred during January in this area ranged from 20 to 25 percent covering industries whose contracts expired in January. This was significantly lower than the average 30 percent readjustment in the majority of industries during the last quarter of 1966. The downtrend is directly attributable to the progressive reduction of the coefficients published monthly by the government for use in its formula for calculating wage readjustments. The Superior Labor Court has not yet rendered a final decision on employer appeals from readjustments of 30 percent set by the Regional Labor Court last November and December affecting an estimated 400,000 Paulista workers in several key industrial sectors. The higher court provisionally cut the readjustment to 24.46 percent, the result of strict application of the government wage formula.

Considerable confusion still persists in both labor and management circles regarding the practical consequences and implementation of the recent law

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establishing the Guarantee Fund for Length of Service which sets up a complicated alternative to the traditional job security (estabilidade) provisions. According to some reports, many companies are pressuring workers, especially newly-hired hands, to opt for the Guarantee Fund alternative. Meanwhile, union leaders have urged their members to exercise great caution in making their choice.

No sharp change in the employment picture has been reported in January. Textile employment continues slack, and one leading chain of textile mills has reduced its workweek and its workers' take-home pay correspondingly. Some metal-fabricating plants have cut back on overtime. (JLiebof)

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